

DEPARTMENT OF STATE REVENUE**LETTER OF FINDINGS NUMBER: 06-0213****Sales Tax
For Tax Year 2005**

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE**I. Sales Tax—Rental Exemption**

Authority: *Gregory v. Helvering*, 293 U.S. 465 (1935); *Commissioner v. Transp. Trading and Terminal Corp.*, 176 F.2d 570, 572 (2nd Cir. 1949); *Horn v. Commissioner of Internal Revenue*, 968 F.2d 1229, 1236-7 (D.C. Cir. 1992); *Indiana Department of Revenue v. Interstate Warehousing, Inc.*, 783 N.E.2d 248, 250 (Ind. 2003); IC § 6-2.5-5-8; IC 6-8.1-5-1; 45 IAC 2.2-5-15; *Black's Law Dictionary 6th Edition* (West 1990)

Taxpayer protests the denial of eligibility for the rental and leasing exemption.

STATEMENT OF FACTS

Taxpayer bought an aircraft and claimed an exemption from sales tax on the purchase of the aircraft. As the result of an investigation, the Indiana Department of Revenue ("Department") determined that taxpayer was not eligible to claim this exemption and issued a proposed assessment for sales tax on the purchase of the aircraft. Taxpayer argues that it is eligible for the exemption and not subject to sales tax on the purchase of the aircraft. Further facts will be supplied as required.

I. Sales Tax—Rental Exemption**DISCUSSION**

Taxpayer protests the Department's decision that taxpayer is not eligible for the rental and leasing exemption for sales tax. Taxpayer states that it is in the business of renting and leasing the aircraft, and that it therefore qualifies for the exemption. As explained by IC § 6-8.1-5-1(b), the burden of proving a proposed assessment wrong rests with the person against whom the assessment is made. Also, the Indiana Supreme Court explained in *Indiana Department of Revenue v. Interstate Warehousing, Inc.*, 783 N.E.2d 248, 250 (Ind. 2003), that exemption

statutes are strictly construed against a taxpayer so long as the intent and purpose of the legislature is not thwarted.

The exemption is found at IC § 6-2.5-5-8(b), which states:

Transactions involving tangible personal property other than a new motor vehicle are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business without changing the form of the property.

The exemption is further clarified by 45 IAC 2.2-5-15, which states:

(a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.

(b) General rule. Sales of tangible personal property for resale, rental or leasing are exempt from tax if all of the following conditions are satisfied:

(1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it;

(2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and

(3) The property is resold, rented or leased in the same form in which it was purchased.

(c) Application of general rule.

(1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or leasing the property. This exemption does not apply to purchasers who intend to consume or use the property or add value to the property through the rendition of services or performance of work with respect to such property.

(2) The purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. Occasional sales and sales by servicemen in the course of rendering services shall be conclusive evidence that the purchaser is not occupationally engaged in reselling the purchased property in the regular course of his business.

(3) The property must be resold, rented or leased in the same form in which it was purchased.

After reviewing the documentation sent in during its investigation, the Department determined that taxpayer did not meet the requirements placed by 45 IAC 2.2-5-15(c)(1) and 45 IAC 2.2-5-15(c)(2).

Taxpayer disagrees with the Department's determination and states that it is a valid LLC in good standing with the State of Indiana. Taxpayer also states that it remitted sales tax from rental fees to the Department. Taxpayer states that it aggressively marketed the rental of the aircraft, and

submits that this is evidence that it was in the business of renting the aircraft. Taxpayer did not provide copies of any advertising materials to support this position.

Taxpayer states that the Department is erroneously focused on the insurance policy taxpayer obtained for the subject aircraft. Taxpayer states that the Department misunderstands the policy in general and Item 10 of the Coverage Identification Page in particular. Item 10 of the Coverage Identification Page states:

THE USE OF THE AIRCRAFT: The aircraft will be used for your pleasure and business related purposes where no charge is made for such use and also will be used for the following purposes:

NO OTHER USE APPROVED

(Emphasis in original)

Taxpayer states that Item 10 of the Coverage Identification and Part One-General Provisions and Conditions-Paragraph 4 are amended by an Endorsement to permit taxpayer to rent the aircraft for up to \$175 per hour, excluding fuel. That amendment states in relevant part:

DIRECT OPERATING EXPENSES

AIRCRAFT EXPENSES \$ 175 Per hour Excluding fuel

This endorsement extends Item 10 of **your** Coverage Identification Page and **Part One – General Provisions and Conditions** – Paragraph 4 “the use of the **aircraft**” to allow **Your** receiving reimbursement for **limited operating expenses** of a specific flight.

This endorsement amends **PART ONE – GENERAL PROVISIONS AND CONDITIONS** Paragraph 1 “Words and Phrases” to include the following;

a. **Limited direct operating Expenses** means:

1. Expenses not to exceed the AIRCRAFT EXPENSES shown above.
2. Travel expenses of the crew including food, lodging, and ground transportation;
3. Hangar tie-down costs away from the location of the aircraft as shown in Item 4 of your Coverage Identification Page.
4. Insurance obtained for the specific flight;
5. Landing fees, airport taxes and similar assessments;
6. Customs, foreign permit, and similar fees directly related to the flight;
7. **in flight** food and beverages;
8. Passenger ground transportation;
9. Flight planning and weather contract services;

NOTHING HEREIN CONTAINED SHALL BE HELD TO VARY, ALTER OR EXTEND ANY OF THE TERMS, CONDITIONS OR AGREEMENTS OF THE POLICY OTHER THAN AS STATED ABOVE.

(Emphasis in original)

Taxpayer states that the Department errs in relying on the term “reimbursement” in the Endorsement as somehow establishing that taxpayer cannot rent the aircraft. Taxpayer states that this is merely semantics and does not preclude taxpayer from renting the aircraft.

The definition of “reimburse” in *Black’s Law Dictionary 6th Edition* (West 1990) states:

To pay back, to make restoration, to repay that expended; to indemnify, or make whole.
(*Id.*, at 1287)

The definition of “rent” in *Black’s* is:

Consideration paid for use or occupation of property. In a broader sense, it is the compensation or fee paid, usually periodically, for the use of any rental property, land, buildings equipment, etc.
...
(*Id.*, at 1297)

There is therefore a clear and fundamental difference between the words “rent” and “reimburse.” The insurance policy is an agreement between taxpayer and the insurer that taxpayer would only let others reimburse taxpayer for taxpayer’s efforts in flying the aircraft. The amendment’s provisions clearly anticipate reimbursement for taxpayer’s activities. The policy does not allow taxpayer to accept payment for other’s direct use of the aircraft. In other words, reimbursement activities are covered by the policy, while rental activities are not. Also, the leasing agreements submitted by taxpayer are for general leasing, not specific flights, as required by the amendment.

Taxpayer states that any business is free to choose whether or not to insure its property. While this is true, the Department is not convinced that a bona fide rental company in a bona fide rental transaction would allow the aircraft it purchased for \$387,300 to be flown without insurance coverage. Rental of the aircraft for use by another would be flying without insurance coverage under the policy presented to the Department. Taxpayer has not provided any documentation to suggest, let alone establish, that there were any other insurance policies covering the aircraft. Since the rental agreements as written would result in the aircraft being flown without insurance, it is not unreasonable to conclude that the parties’ lease agreement falls within the definition of a “sham transaction.” The “sham transaction” doctrine is long established both in state and federal tax jurisprudence dating back to *Gregory v. Helvering*, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. *Id* at 469. A corporate business activity undertaken merely for the purpose of avoiding taxes was without substance and “[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.” *Id* at 470. The courts have subsequently held that “in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape

taxation.” *Commissioner v. Transp. Trading and Terminal Corp.*, 176 F.2d 570, 572 (2nd Cir. 1949), cert. denied, 338 U.S. 955 (1950). “[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer’s desire to secure the attached tax benefit” but are devoid of any economic substance. *Horn v. Commissioner of Internal Revenue*, 968 F.2d 1229, 1236-7 (D.C. Cir. 1992). Taxpayer claimed an exemption for renting the aircraft when it knew that it was prohibited from renting the aircraft by the language of the insurance policy. Since taxpayer was not involved in valid leases or rental agreements, the Department was correct to deny taxpayer’s claim for the rental/lease exemption.

In conclusion, taxpayer’s own insurance policy prohibits it from renting the aircraft. The only money taxpayer can receive is in the form of reimbursement for its activities involving use of the aircraft. 45 IAC 2.2-5-15(c)(1) plainly states that the exemption does not apply to purchasers who intend to consume or use the property or add value to the property through the rendition of services or performance of work with respect to such property. The difference between “rent” and “reimbursement” is not merely semantics, as explained by *Black’s* and the insurer’s language in the policy. Here, the exemption statute is strictly construed against a taxpayer since the intent and purpose of the legislature is not thwarted, as provided in *Interstate Warehousing*. The Department was correct in its determination that taxpayer’s documentation shows that taxpayer is not eligible for the rental and leasing exemption.

FINDING

Taxpayer’s protest is denied.

WL/BK/DK February 12, 2007